Supreme Court, U.S.
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No. _____

IN THE SUPREME COURT OF THE UNITED STATES

DANESHJOU COMPANY, INC., et al.
Petitioner

VERSUS

MID-CONTINENT CASUALTY COMPANY
Respondent

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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PARTIES AND CORPORATE DISCLOSURE

The undersigned counsel of record certifies the following listed parties to the proceedings, pursuant to Supreme Court Rule 14.1(b):

1. Mid-Continent Casualty Company
   PO Box 149
   Tulsa, Oklahoma 74101

2. Daneshjou Company, Inc.
   PO Box 161326
   Austin, Texas 78716

3. Sally Daneshjou
   Individual resident of Travis County, Texas
   67 St. Stephens Road
   Austin, Texas 78746

4. M.B. "Benny" Daneshjou
   Individual resident of Travis County, Texas
   67 St. Stephens Road
   Austin, Texas 78746

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The corporation entitled Daneshjou Company, Inc. ("DCI") has no parent corporation nor does any publicly held company own any percentage of stock in DCI.

The corporation is solely owned by Sally Daneshjou.

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CITATION OF OPINION ISSUED IN THIS CASE

Mid-Continent Cas. Co. v Daneshjou Co., 2006 U.S. App. LEXIS 30795 (5th Cir. 2006) (unpublished opinion).

BASIS FOR JURISDICTION

Jurisdiction is proper in this Court pursuant to Supreme Court Rule 10(c) because the instant decision concerns an important matter of law that has not been decided in the current context by this Honorable Court or by the United States Courts of Appeals; that is, ***at what point does latent damage "manifest" for purposes of insurance coverage (duty to defend and indemnify) within the context of construction of residential property.*** This issue is very important in the current economy and has not been definitively answered.

Also, the instant matter is properly before this Court for writ of certiorari because the United States Court of Appeals for the Fifth Circuit's decision affirming the District Court's judgment conflicts with its prior decision in *American Home Assurance v. Unitramp, Ltd.*, 146 F.3d 311 (5th 1998) concerning the manifestation rule as applied to latent defects. Although *Unitramp* did not involve construction defects, it did involve latent "damage" (*i.e.*, defective fuel in a ship). The appellate court held that the "date of occurrence," to invoke coverage under the manifestation rule, was when the damage is "capable of being easily ***perceived, recognized and understood***." *American Home Assur. Co. v. Unitramp Ltd.*, 146 F.3d 311, 314 (5th Cir. 1998) (emphasis added). *Unitramp* is the only case that comes close to being applicable to the instant situation, where latent construction defects that require destructive, complex testing is required to adequately perceive and understand the alleged damages.

The judgment of the United States Court of Appeals for the Fifth Circuit was filed on December 14, 2006. No rehearing was requested by Petitioners. Thus, pursuant to Supreme Court Rule 13, this petition for writ of certiorari is timely filed if filed within 90 days from December 14, 2006 – or by March 14, 2007.

STATEMENT OF THE CASE

This matter concerns the duty of a liability insurer to defend and indemnify arising out of an underlying lawsuit, commenced on June 21, 2001, in which Sandra and John Bullock (and a Trust managed by them) secured a $7,964,037.00 judgment against the architect/builder, M.B. Daneshjou, and his company, Daneshjou Company, Inc. ("DCI"), for improper construction and fraud in connection with construction of a residence for Sandra Bullock in Travis County, City of Austin, Texas.[1] *Jurisdiction was proper in the*

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1 R. at 629. DCI initiated the lawsuit against the Bullocks seeking payments under a construction contract and change orders related to the construction of a residence for Sandra Bullock. *Id.* The Bullocks counterclaimed, asserting that DCI and M.B. Daneshjou had improperly constructed the residence and had committed fraud. Specifically, the Bullocks alleged that Petitioners had: (1) overbilled, (2) unreasonably delayed construction, (3) billed for work not performed, (4) billed for work performed to repair their own defective work, (5) filed for unnecessary work, (6) failed to account to account for actual costs incurred including management, overhead, and architectural fees. The Bullocks claimed that Petitioners had breached the construction contract, committed statutory fraud, committed real estate fraud, committed common law fraud, fraudulently induced the Bullocks to enter into the construction contract, breached the Texas Deceptive Trade Practices Act, breached expressed and implied warranties, and breached their fiduciary duty. R. at 628.

The Bullocks filed their Second Amended Original Answer, Second Amended Counterclaim and Second Amended Third Party Action on February 2, 2004. R. at 470 – Attachment "C" in Petitioners' Summary Judgment Response Appendix contained in separate expandable folder as part of record. The Second Amended Petition includes a separately enumerated section as follows:

> "VIII. NEGLIGENT MISREPRESENTATION" that incorporates by reference all the preceding factual allegations in the other paragraphs and then goes on to state additional facts in § 8.02, which included in pertinent part: "The Defendants failed to exercise reasonable care or competence . . ." and "plaintiff

United States District Court for the Western District of Texas based on diversity of citizenship.

Judgment was entered against Petitioners on November 18, 2004 in the underlying Bullock litigation following a lengthy jury trial. Subsequent to that judgment, Petitioners settled with the Bullocks. The insurer then sought a declaration from the District Court that it did not have a duty to defend or indemnify or provide coverage to DCI or M.B. Daneshjou in connection with the Bullock litigation.[2]

Mid-Continent Casualty Company ("Mid-Continent") filed the instant declaratory action against the Daneshjou Company, Inc. ("DCI"), M.B. "Benny" Daneshjou, Sandra Bullock, and John W. Bullock, individually and as Trustee of the Band Aid Trust on March 14, 2005.[3] The insurer's pleading was entitled Plaintiff's Original Complaint for Declaratory Judgment.[4]

In the petition, Mid-Continent sought "construction of a Commercial General Liability policy . . ."[5] and alleged that it had no duty to defend or indemnify Petitioners in the underlying Bullock construction litigation under the policies

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justifiably relied on the false representations from defendant/s and due to such negligent misrepresentation, ..." *Id.*

Mid-Continent contended that the policies issued to Petitioners did not provide a duty to defend or to indemnify DCI or Daneshjou from the allegations made by the Bullocks. It asserted that the allegations and the facts proven at trial fell outside the policy's period and, alternatively, that even if they came within the coverage period, they did not establish an occurrence, property damage, or bodily injury as those terms are defined in each policy. *Id.* Consequently, Respondent sought a declaratory judgment from the Western District Court, Austin Division, that it owed no duty to defend or indemnify Petitioners relative to the Bullocks' allegations.

2 R. at 629.

3 R. at 1-6.

4 *Id.*

5 *Id.* at 1.

that it had issued to Petitioners.[6] That underlying litigation had resulted in a jury verdict, with final judgment exceeding $7.94 million entered against Petitioners on November 18, 2004.[7] Subsequent to that judgment, Petitioners settled with the Bullocks and the instant lawsuit commenced concerning Mid-Continent's extent of coverage under the policies it had issued to Petitioners.

The Bullocks filed their Answer and Counterclaim on June 30, 2005.[8] They offered a general denial to the complaint and counterclaimed that Mid-Continent was obliged under its policies with Petitioners to satisfy the judgment obtained by the Bullocks against Petitioners in the underlying litigation.[9] Further, the Bullocks contended therein that Mid-Continent had breached its contract with Petitioners by failing to honor the terms of the insurance policy that required a defense and indemnification of Petitioners by the insurer.[10]

On July 1, 2005, the District Court ordered the parties to confer and submit a proposed scheduling order for its consideration by August 29, 2005.[11]

Mid-Continent filed its Answer to the Bullocks' counterclaim on July 20, 2005 in which it denied that it was obliged to provide any representation to Petitioners under the

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6 *Id.* at 4-5. As background, Mid-Continent had issued a series of policies covering DCI: (1) a commercial general liability policy, effective September 29, 2000 through September 29, 2001; (2) an excess policy, effective March 26, 2001 through March 26, 2002; (3) a commercial general liability policy, effective September 29, 2001 through March 26, 2002; (4) a commercial general liability policy, effective June 20, 2002 through June 20, 2003; and (5) a commercial general liability policy, effective June 20, 2003 through June 20, 2004. *See* R. at 628.

7 R. at 629.

8 R. at 7-13.

9 R. at 10-12.

10 *Id.*

11 R. at 14-15.

policies.[12] Specifically, Mid-Continent asserted that no "occurrence" was alleged that would trigger coverage under the policies, nor was any "accident," "bodily injury," or "property damage" alleged sufficient to invoke coverage.[13] Moreover, Mid-Continent alleged that certain exclusions in the policies precluded its duty to defend or indemnify Petitioners in the underlying Bullock litigation.[14]

Petitioners filed their Answer and Counterclaim on August 22, 2005 in which they denied the allegations of Mid-Continent's complaint and asserted via counterclaim that Mid-Continent: (1) had breached its contract with Petitioners, (2) violated the Texas Deceptive Trade Practices Act ("DTPA") and Texas Insurance Code, and (3) owed Petitioners actual damages, economic damages, consequential damages, treble damages, and attorney's fees.[15] Further, Petitioners also sought a declaratory judgment from the District Court.[16]

Mid-Continent filed its Answer to Petitioners' counterclaim on September 7, 2005 in which it offered a general denial to Petitioners' assertions and reiterated its affirmative defenses.[17]

On October 18, 2005, the Bullocks filed a Motion to Dismiss and Substitute Parties in which they explained to the court that they had settled the November 2004 judgment and resolved all claims between them on August 5, 2005 during the pendency of Mid-Continent's instant action.[18] Additionally, on that same date, Sally Daneshjou and the Bullocks entered into a Transfer Lawsuit agreement in which all claims, counterclaims,

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12 R. at 20-28.
13 R. at 24-25.
14 R. at 25-26.
15 R. at 37-43 [NOTE: The pages of the pleading are out of order in the record, but all pages are contained therein.]
16 *Id.*
17 R. at 46-52.
18 R. at 55.

and defenses that the Bullocks had in the Mid-Continent litigation were assigned to Sally Daneshjou.[19] Thus, the Bullocks moved the court to dismiss them entirely from the instant litigation with Mid-Continent.[20]

Mid-Continent filed its Response to the Motion to Dismiss and Substitute Parties on October 28, 2005.[21] In that pleading, the insurer opposed the requested dismissal of the Bullocks, contending that the motion was premature and defective.[22]

Sally Daneshjou filed her Motion to Intervene on November 14, 2005.[23] The District Court granted same on November 16, 2005.[24]

In that same Order, the court also gave the Bullocks twenty days to provide Mid-Continent all correspondence and photographs exchanged between the parties and the experts in the underlying litigation.[25]

Sally Daneshjou filed her Complaint in Intervention on November 16, 2005 in which she asserted claims against Mid-Continent as the assignee of the Bullocks' interests; thus, bringing the declaratory relief and breach of insurance contract claims against the insurer.[26]

Mid-Continent filed its Original Answer and Counterclaim to Sally Daneshjou's Complaint in Intervention on December 2, 2005, essentially reiterating what had been pled before.[27]

On December 21, 2005, Sally Daneshjou filed a Motion

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19 *Id.*
20 R. at 57.
21 R. at 61-71.
22 R. at 62-70.
23 R. at 162-66.
24 R. at 195-96.
25 *Id.*
26 R. at 197-200.
27 R. at 243-58.

to Dismiss and, Alternatively, a Motion to Stay Mid-Continent's suit for failure to join an indispensable party: Truck Insurance Exchange.[28]

The following day, December 22, 2005, Mid-Continent filed its Motion for Summary Judgment.[29] Mid-Continent also filed its First Amended Original Complaint for Declaratory Judgment on December 29, 2005[30] and its First Amended Answer to Petitioners' Counterclaim.[31] On that same date, Mid-Continent also filed its First Amended Answer to the Bullocks' Counterclaim[32] and its First Amended Original Answer and First Amended Counterclaim to Sally Daneshjou's Complaint in Intervention.[33]

On January 6, 2006, Mid-Continent filed its Response to the Daneshjou's Motion to Dismiss or Stay arguing that such motion would become moot if the District Court granted its Motion for Summary Judgment and that Truck Insurance Exchange was not an indispensable party because Truck allegedly had settled its claims with the Daneshjous.[34]

Petitioners filed their Response to Mid-Continent's Motion for Summary Judgment on January 13, 2006.[35] ***In that pleading, Petitioners argued that a genuine fact existed as to whether the construction defects "manifested" before the effective date of the first Mid-Continent policy and, as such, that summary judgment was inappropriate.***[36] Additionally, Petitioners argued that ***a genuine issue of fact existed as to whether the claims of overcharges "manifested" within the***

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28 R. at 299-309.
29 R. at 330-39.
30 R. at 386-94.
31 R. at 395-403.
32 R. at 404-13.
33 R. at 414-32.
34 R. at 434-38.
35 R. at 457-69.
36 R. at 458-63.

policy's coverage period.[37] Petitioners also asserted that punitive damages are within the coverage provided by the Mid-Continent policy.[38] Moreover, Petitioners maintained that attorney's fees are recoverable as a foreseeable result of the insurer's breach of its duty to defend under the insurance contract and that the damages awarded in the underlying Bullock litigation constituted "prop(ty damage" under the policy.[39]

Mid-Continent replied to Petitioners' Response on January 27, 2006.[40]

On February 14, 2006, the District Court, by Order signed that date: (1) granted the Bullocks Motion to Dismiss and to Substitute Sally Daneshjou; (2) denied Petitioners' and Sally Daneshjou's Motion to Dismiss and Alternative Motion to Stay; and (3) granted Mid-Continent's Motion for Summary Judgment.[41] The Judgment was signed that same date.[42]

The District Court granted summary judgment and issued eight pages of reasons for doing so.[43] The court acknowledged that the Texas Supreme Court has never explicitly adopted a specific theory governing the triggering event for the insurer's duty to defend, but relied upon this Court's jurisprudence to select the "manifestation theory" for the analysis.[44] The District Court concluded: "Thus, because the matters at issue in the Underlying Litigation manifested

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37 R. at 463.

38 R. at 463-65.

39 R. at 465-67.

40 R. at 488-93.

41 R. at 627-45.

42 R. at 646.

43 *See* R. at 636-44.

44 R. at 638-39. The court specifically relied upon *Guaranty Natl'l Ins. Co. v. Azrock Indus., Inc.*, 211 F.3d 239, 247-48 (5th Cir. 2000). According to the District Court, the Fifth Circuit recognized that the proper theory to use in cases involving property damage is the manifestation theory. *See* R. at 638

themselves prior to the effective date of any of the Policies, those matters fell outside of the coverage provided by the Policies."[45] The court continued: "Accordingly, the Court concludes MCC had no duty to defend, and consequently to indemnify, under the Policies."[46]

Although the District Court acknowledged the existence of at least five other legal arguments concerning the issue of punitive damages, such as whether the damages constituted "property damage" arising from an "occurrence," whether punitive damages violates Texas's public policy (different case certified on that question to the Texas Supreme Court), and whether such damages equal "economic damages," the court concluded that because the [court] has found the Policies did not extend coverage to [Petitioners] for the matters at issue in the Underlying Litigation, thus placing no duty to defend under the Policies on MCC, a ruling on MCC's additional arguments is unnecessary."[47]

Petitioners filed a Motion for Reconsideration of Summary Judgment on March 1, 2006,48 which was denied on March 27, 2006.[49]

On appeal, the Court of Appeals affirmed the judgment of the District Court and filed its judgment on December 14, 2006. This Petition for Writ of Certiorari followed.

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45 R. at 643.
46 R. at 644.
47 R. at 644.
48 R. at 647-54.
49 R. at 660-64.

LAW AND ARGUMENT

I. WRIT GRANT IS IMPORTANT IN CURRENT ECONOMY AND RESIDENTIAL CONSTRUCTION CONTEXT

This case presents an important issue of first impression in the specific context presented by the case *sub judice*. The construction business is vital to the economy in the City of Austin, Texas where an abundance of older homes are being rebuilt to accommodate more modern tastes and new construction is also thriving. In the current construction context, the prevalence of ***latent construction defects*** is common. Such latency results in lengthy litigation over the exact point at which the alleged damages occurred for purposes of invoking insurance coverage under the manifestation rule. Unfortunately, the federal case law on point is not so prevalent.

Numerous cases address latent damages in the context of medical disease, such as asbestosis, and the discovery rule has been held to apply in those situations where the exposure occurred years before the disease manifested. *See Guaranty Nat'l Ins. Co. v. Azrock Indus., Inc.*, 211 F.3d 239 (5th Cir. 2000). But, in the current context of construction, where the damage also may not become apparent until later, and the actual understanding of the damage is not possible without extensive testing, including destructive measures, Petitioners ask this Court to settle the law concerning when the damage is considered to have "occurred" for purposes of invoking insurance coverage.

As the instant case demonstrates, when an upscale residence is constructed, numerous subcontractors participate in the actual building of the residence. Although perhaps Sandra Bullock's over $6 million residence might be higher

end than most, the concept remains the same; namely, that when an architect/builder constructs a large house, the project contains many opportunities for mistakes, defects, and problems that may not appear until much later. The builder may not always be aware of cost-saving measures, or just plain negligence, that occurs on the part of some of the subcontractors. Nonetheless, the architect/builder, as in this case before you, is held liable for the construction defects that result.

Also common to the industry is the issue of insurers disputing coverage when faced with a multi-million dollar adverse judgment, as the case at bar presents. Petitioners paid their premiums to Mid-Continent for the general commercial liability coverage, but when that coverage was needed, the insurer wiggled out of not only the indemnification, but also its duty to defend. Mid-Continent failed to defend Daneshjou Company in the underlying lawsuit and also managed to escape providing indemnity to cover the final $7.96 million judgment. Petitioners respectfully ask this Court to appreciate the lack of jurisprudence in the specific construction context and grant its writ for certiorari to elucidate the law in this vital subject area.

The Fifth Circuit and this Court review the grant of a summary judgment motion by the District Court *de novo*. *Ellis v. Liberty Life Assur. Co.*, 394 F.3d 262, 269 (5th Cir. 2004); *FDIC v. Meyers*, 955 F.2d 348, 349 (5th Cir. 1992) ("The standard of review for a summary judgment is well settled: We review the record *de novo* to ascertain whether any genuine issue exists as to any material fact and, upon finding none, to ascertain whether the moving party is entitled to a judgment as a matter of law. Fed.R.Civ.P. 56(c); *Miles v. American Tel. & Tel. Co.*, 703 F.2d 193 (5th Cir.1983).").

Thus, this Court uses the same criteria as the Fifth Circuit and the Western District Court in determining whether summary judgment was properly granted. *Patterson v. Mobil Oil Corp.*, 335 F.3d 476, 487 (5th Cir. 2003) ("As noted above,

we review a grant or denial of summary judgment *de novo*, using the same criteria employed by the district court. *Mongrue v. Monsanto Co.*, 249 F.3d 422, 428 (5th Cir. 2001). Summary judgment is proper if, drawing all inferences in favor of the non-moving party, there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *Id.*; Fed. R. Civ. P. 56(c).").

In further elaboration of the requisite appellate review standard, the Fifth Circuit, in *American Home Assur. Co. v. Unitramp Ltd.*, 146 F.3d 311 (5th Cir. 1998), advised that it "review[s] factual findings for clear error and conclusions of law *de novo*. *Williams v. Fab-Con, Inc.*, 990 F.2d 228, 230 (5th Cir. 1993). An insurance policy is a contract subject to traditional rules of contract interpretation. *F.D.I.C. v. Firemen's Ins. Co.*, 109 F.3d 1084, 1087 (5th Cir. 1997) (per curiam). We construe any ambiguities in an insurance contract strictly in favor of the insured. *Id.*" *Unitramp*, 146 F.3d at 313.

In the instant matter, the District Court applied the "manifestation theory," which holds that an "occurrence" triggering coverage exists not when the causative negligence occurs, but rather on the date that the damage becomes capable of being easily perceived or recognized. *See Guaranty Nat'l Ins. Co. v. Azrock Indus., Inc.*, 211 F.3d 239,246-47 (5th Cir. 2000). The court looked to the allegations in the Bullocks' Second Amended Counterclaim and concluded that "the matters at issue manifested themselves prior to the effective date of any of the Policies [and, therefore,] those matters fell outside of the coverage provided by the Policies."[50]

Petitioners assert, however, that they presented sufficient evidence to establish genuine issues of fact that required the District Court to deny the motion for summary judgment and, rather, to conduct a trial to evaluate all that evidence. Petitioners argued below that the requisite

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50 R. at 643.

"manifestation" had not occurred until the extensive destructive testing by the consulting engineers was completed and the results analyzed. That date of completion of the testing/analysis occurred ***after the insurance policies became effective, and therefore, coverage by Mid-Continent was triggered.***

Applying the *de novo* standard of review, this Court may review the allegations, the applicable law governing "manifestation" and "occurrences," in addition to the other arguments and evidence presented by counsel, to determine whether the Fifth Circuit correctly affirmed the District Court. Petitioners respectfully contend that when such analysis is performed by this Court under the *de novo* standard of appellate review, this Court will agree that Petitioners' petition for writ of certiorari should be granted and the decision of the Fifth Circuit reversed in this important area of law.

II. THE DISTRICT COURT MISINTERPRETED THE MANIFESTATION THEORY AS IT APPLIES TO LATENT CONSTRUCTION DEFECTS

Texas courts follow the "Eight Corners" or "Complaint Allegation" rule when determining whether there is a duty to defend. *Potomac Ins. Co. v. Jayhawk Med. Acceptance Corp.*, 198 F.3d 548, 551 (5th Cir. 2000); *Gulf Chem. & Metallurgical Corp. v. Associated Metals & Minerals Corp.*, 1 F.3d 365, 369 (5th Cir.1993). Under this rule, courts must determine whether an insurer owes a duty to defend solely from the allegations in the underlying complaint and the language of the insurance policy. *Id.* The focus is on the facts alleged in the complaint, not on the legal theories. *Id.* The duty to defend is determined by examining the latest amended pleadings. *Rhodes v. Chicago Ins. Co.*, 719 F.2d 116, 120 (5th Cir.1983).

Moreover, the duty to defend arises when the facts

alleged in the petition, if taken as true, potentially state a cause of action within the terms of the policy. *Gulf Chem.*, 1 F.3d at 369. An insurer is obligated to defend ***if the petition alleges at least one cause of action within the policy's coverage***. *Rhodes*, 719 F.2d at 119 (emphasis added). The insured bears the burden of showing that the claim against him is potentially within his policy's scope of coverage. *Harken Exploration Co. v. Sphere Drake Ins. P.L.C.*, 261 F.3d 466, 471 (5th Cir. 2001); *Sentry Ins. v. R.J. Weber Co.*, 2 F.3d 554, 556 (5th Cir.1993).

The Fifth Circuit recently examined the four legal theories applicable in different contexts to determine the issue of an insured's duty to defend its insured. *See Guaranty Nat'l Ins. Co. v. Azrock Indus., Inc.*, 211 F.3d 239 (5th Cir. 2000). In that case, the appellate court stated its inquiry as follows: "We must decide what event triggers an insurer's duty to defend its insured against asbestos-related personal injury claims under a Commercial General Liability ("CGL") policy, here, one issued by Guaranty National to Azrock." *Id.* at 241. In examining the various legal theories to determine insurance coverage, the Fifth Circuit concluded that the "manifestation theory" is the appropriate one to utilize for "property damage" cases. *Id.* at 247-48.

Particularly instructive for the instant case, which involved the continuous discovery of ***latent*** defects through a lengthy process that involved destructive testing and multiple engineers' study and reports, is the Fifth Circuit's analysis in *American Home Assur. Co. v. Unitramp Ltd.*, 146 F.3d 311 (5th Cir. 1998). That litigation involved the discovery of water in a vessel's fuel tank and the determination of when the property damage "occurred" for purposes of insurance coverage. The court of appeals construed the inquiry in *Unitramp* as:

> ***The instant dispute hinges on precisely when the mishap is deemed to have "occurred."*** As of June 9 -- the day the watered fuel was

> loaded -- American's policy did not extend coverage to liabilities arising from operations at the Ingleside facility. Effective as of noon on June 12, however -- two days before Unitramp learned that the fuel did not meet specifications -- the policy was renewed and the Ingleside facility added as a scheduled location. American argues that damage occurred on June 9 when the fuel was loaded aboard the GLENITA; Unitramp contends that because the harm did not become manifest until the laboratory had forwarded the test results, the date of occurrence is June 14.

Unitramp, 146 F.3d at 312 (emphasis added).

All parties agreed in *Unitramp* that Texas law governed the dispute, as it does in the instant case. The Fifth Circuit summarized the applicable state law:

> Texas law provides that "the time of the occurrence is when the complaining party actually was damaged, not the time that the wrongful act was committed." ***A party sustains actual damage when it sustains damage that is readily apparent***. This is known as the "manifestation rule," and although it has not been expressly adopted by the Texas Supreme Court, the state's lower courts have recognized and applied it. As the court stated in *Cullen/Frost*, 852 S.W.2d 252 at 257, ***"coverage is not afforded unless an identifiable damage or injury, other than merely causative negligence, takes place during the policy period."***

Unitramp, 146 F.3d at 313 (citations omitted) (emphasis added).

The salient issue decided by the Fifth Circuit in *Unitramp*, and similarly applicable to the case at bar, is when the "occurrence" for purposes of coverage is considered to have manifested under the "manifestation theory." Succinctly answering the inquiry, the appellate court concluded that "[t]he date of occurrence is when the damage is capable of being easily perceived, recognized and ***understood***." *Unitramp*, 146 F.3d at 314 (emphasis added). Applying that interpretation to the watered fuel testing at issue in that case, the court explained that: "The watered nature of the fuel was not visible to the naked eye, but required offsite testing to uncover." *Id.*

In analyzing *Unitramp*, the appellate court discussed with approval and applied similar reasoning that a Texas state appellate court had utilized in the context of latent property damage discovered by condominium owners. *See Cullen/Frost Bank v. Commonwealth Lloyd's Ins. Co.*, 852 S.W.2d 252, 257 (Tex.App. – Dallas 1993, writ denied):

> In *Cullen/Frost*, the structural deterioration in condominium units was not apparent because it was hidden; the floor displacement and rotten woodwork were not readily observable by the senses. ***Accordingly, the problems did not become apparent until the owners conducted inspections***. But it is important to understand that "apparent" does not mean "discovered"; just because something is unknown to an individual does not render it, in an objective sense, unapparent. If the plaintiffs in *Cullen/Frost* had purchased a home that was missing a roof -- but through sheer indolence failed to discover the defect for a year -- we

> would not say that the defect became "apparent" on that later date.

Unitramp, 146 F.3d at 314 (emphasis added).

Similarly, in the instant case, Petitioners argued to the lower court that the first draft report (by engineer June Melton) of the 278 construction defects at the Bullock residence, which formed the basis of the original lawsuit, was not issued until September 30, 2000 with a more complete report issued in February 2001. ***Engineer Melton required numerous sub-specialists and many months of testing and analysis to fully "understand" the damage at the Bullock property.*** The Bullocks' claims in the underlying suit based on these alleged construction defects were not raised until September 2001. To conclude, as the District Court did, that the date of Melton's inspections, or even the date of his rendering his initial draft report, was the date of the "occurrence" would be tantamount to holding in *Unitramp* that the date the fuel was sent off for testing was the date of the "occurrence," a position that the Fifth Circuit flatly rejected.

Moreover, Mid-Continent's summary judgment evidence consisted primarily of a report issued by Veritas, Inc., which concluded that all defects raised and priced by the various experts in the underlying litigation related to defects "discovered" by June Melton prior to the effective date of the policy. Even assuming Mid-Continent is correct in that assertion, however, its summary judgment evidence still fails to establish that all the defects ***"manifested"*** themselves during Melton's inspections. Relating back to something in the past is not the equivalent of "manifesting" itself in the present, especially as the term has been defined by the Fifth Circuit.

Indeed, it is reasonable to assume that the actual calculations and analysis of the data obtained by Melton when he examined the residence were performed in the period of time ***following*** the inspection itself, just as the fuel testing was

performed over the several days following its collection from the vessel in *Unitramp*. In the instant case, even more so than in *Unitramp*, the ***continued inspections and destructive testing that were required to establish the grounds for the Bullocks' Second Amended Complaint certainly "occurred" way after the policy's effective date***. In fact, the final Melton report was not submitted until October 14, 2003.

Additionally, even the evidence that Mid-Continent presented in support of its motion for summary judgment raised genuine issues of fact. Veritas identified five areas "that required further investigation and analysis as to when that deficiency was perceived or recognized." Despite this statement, Veritas concluded that all of the defects were the basis of the Bullocks' claims were observed and reported by Melton's initial report. ***That contradiction itself constitutes an essential and clearly genuine fact issue that was not appropriate for summary judgment.***

The District Court erred by granting the motion for summary judgment in lieu of conducting a trial to ferret out these factual issues. The Fifth Circuit erred by affirming that decision. These errors are particularly inequitable since the jurisprudence demands that an insurer is obligated to defend ***if the petition alleges at least one cause of action within the policy's coverage***. *Rhodes*, 719 F.2d at 119. Petitioners had paid for numerous policies to ensure that they would be provided liability coverage.

The lower court erred by failing to analyze the factual issues presented by Petitioners and scrupulously examining all facts before it determined the extent of coverage. Had the lower court correctly applied the jurisprudence to the instant facts, it would have had to conclude that the insurer had a duty to defend and indemnify Petitioners. The Fifth Circuit compounded this error by failing to reverse the Western District Court's erroneous decision and remanding for trial on the factual issues.

III. THE "EIGHT CORNERS" RULE ALSO REQUIRED RESOLUTION IN FAVOR OF PETITIONERS

In addition to application of the "manifestation theory," the lower court, the Fifth Circuit, and now this Court, must employ the "eight corners" rule, as discussed *supra,* to determine whether an insurer has a duty to defend. *Poptomac Ins. Co. v. Jayhawk Med. Acceptance Corp.*, 198 F.3d 548, 551 (5th Cir. 2000). This rule has been held to require the insurer to defend the insured even where the complaint does not state facts sufficient to clearly establish that the case falls within or outside of coverage because ***the general rule is that the insurer is obligated to defend if there is, potentially, a case under the complaint that falls within the coverage of the policy.*** *See Nautilus Ins. Co. v. Nevco Waterproofing, Inc.*, 2005 U.S. Dist. LEXIS 30939 (S.D. Tex. July 11, 2005) (holding that a petition adequately alleged facts to support the reasonable inference that manifestation occurred within the policy period because there were no factual allegations that would exclude a duty to defend); *National Union Fire Ins. Co. v. Merchants Fast Motor Lines*, 939 S.W.2d 139, 141 (Tex. 1997) ("[I]n case of doubt as to whether or not the allegations of a complaint against the insured state a cause of action within the coverage of a liability policy sufficient to compel the insurer to defend the action, such doubt will be resolved in insured's favor.").

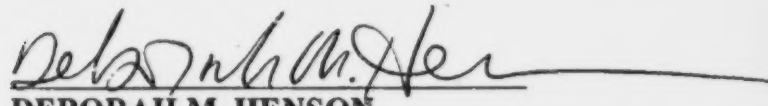
The Bullocks' pleadings are not clear that ***all the defects manifested*** themselves before September 29, 2000. Because all doubts should be resolved in the insured's favor, summary judgment on the issue of manifestation as it related to the duty to defend Petitioners was inappropriate. Petitioners urge this Court to grant its petition for writ of certiorari and to reverse the appellate court's erroneous decision affirming the

lower court.

CONCLUSION

For the foregoing reasons, Petitioners ask this Honorable Court to grant its petition for writ of certiorari and, ultimately, to reverse the Fifth Circuit Court of Appeals' decision affirming the District Court's judgment.

Respectfully submitted,



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APPELLATE ATTORNEYS FOR PETITIONERS

APPENDIX

A. *Mid-Continent Cas. Co. v. Daneshjou Co.*, 2006 U.S. App. LEXIS 30795 (5th Cir. 200) (Unpublished Opinion of the Fifth Circuit Court of Appeals)

B. *Mid-Continent Cas. Co. v. Daneshjou Co., Inc., M.B. Daneshjou, Sandra Bullock and John W. Bullock, Individually and as Trustee of the Band Aid Trust*, United States District Court for the Western District of Texas, Austin Division (filed February 15, 2006)

Appendix A

MID-CONTINENT CASUALTY COMPANY, Plaintiff-Counter Defendant-Appellee, versus DANESHJOU COMPANY, INC.; ET AL, Defendants, DANESHJOU COMPANY, INC.; M.B. DANESHJOU, Defendants-Counter Claimants-Appellants.

No. 06-50552 Summary Calendar

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

2006 U.S. App. LEXIS 30795

December 14, 2006, Filed

NOTICE: [*1] RULES OF THE FIFTH CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

PRIOR HISTORY: Appeal from the United States District Court for the Western District of Texas. USDC No. 1:05-CV-182-SS.

DISPOSITION: AFFIRMED.

COUNSEL: For MID-CONTINENT CASUALTY CO, Plaintiff - Counter Defendant - Appellee: Richard Phillips Hogan, Jr, Jennifer Bruch Hogan, Pillsbury Winthrop Shaw Pittman, Houston, TX.

For DANESHJOU COMPANY INC; M B DANESHJOU, Defendants - Counters Claimants - Appellants: Trey L Dolezal, Kasling, O'Toole, Hemphill & Dolezal, Austin, TX.

JUDGES: Before REAVLEY, GARZA, and BENAVIDES, Circuit Judges.

OPINION: PER CURIAM: *

> * Pursuant to 5TH CIR. R. 47.5, the Court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

Daneshjou Company Inc. and M.B. Daneshjou (collectively "Daneshjou") appeal the district court's summary declaratory judgment [*2] that Mid-Continent Casualty Company owes Daneshjou no duty to defend or indemnify. We affirm for the reasons given by the district court in its very thorough discussion of the issue of manifestation and the evidence regarding the same.

AFFIRMED.

APPENDIX B

JUDGMENT & ORDER:

Case No. A-05-Ca-182-SS; *Mid-Continent Casualty Company v. Daneshjou Company, Inc., M.B. Daneshjou, Sandra Bullock, and John W. Bullock, Individually And As Trustee Of The Band Aid Trust;* In the United States District Court for the Western District of Texas

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RETYPED UPON DIRECTION OF M. BLALOCK OFFICE OF THE CLERK, SUPREME COURT OF THE UNITED STATES

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

Case No. A-05-CA-182-SS

MID-CONTINENT CASUALTY COMPANY
-vs-
DANESHJOU COMPANY, INC., M.B. DANESHJOU, SANDRA BULLOCK, and JOHN W. BULLOCK, INDIVIDUALLY AND AS TRUSTEE OF THE BAND AID TRUST

JUDGMENT

BE IT REMEMBERED that on the 14th day of February, 2006, the Court entered its order granting summary judgment on behalf of Plaintiff Mid-Continent Casualty Company, and thereafter enters the following judgment:

IT IS ORDERED, ADJUDGED, and DECREED that Plaintiff has no duty to defend or indemnify Defendants and has no liability of insurance to the Defendants as the result of this lawsuit, and that all costs of this suit are taxed against Defendants Daneshjou Company, Inc., M.B. Daneshjou, and Sally Daneshjou, for which let execution issue.

SIGNED on this the 14th day of February, 2006.

//original signed by Sam Sparks//

SAM SPARKS
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

Case No. A-05-CA-182-SS

MID-CONTINENT CASUALTY COMPANY

-vs-

DANESHJOU COMPANY, INC., M.B. DANESHJOU, SANDRA BULLOCK, and JOHN W. BULLOCK, INDIVIDUALLY AND AS TRUSTEE OF THE BAND AID TRUST

ORDER

Before the Court are Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of the Band-Aid Trust's Motion to Dismiss and Substitute Parties, filed October 18, 2005 [#13]; Plaintiff Mid-Continent Casualty Company's Response to Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of the Band-Aid Trust's Motion to Dismiss and Substitute Parties, and supporting Appendix, filed October 28, 2005 [#15]; Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of Band-Aid Trust's Reply to Mid-Continents Response to Motion to Dismiss and Substitute Parties, filed November 14, 2005 {#53]; Bullock Interests' Counsel's Report of Production of Correspondence and Photographs Pursuant to Court's Order, filed December 6, 2005 [#34]; Defendants M.B. Daneshjou, Daneshjou Company, Inc., and Sally Daneshjou Motion and Notice of Motion to Dismiss and Alternative Motion to Stay, filed December 21, 2005 [#39]; Mid-Continent Casualty Company's Motion for Final Summary Judgment, and supporting Appendix, filed

December 22, 2005 [#40 & #41]; Bullock Interests' Counsel's Notice of Absence of Objection, filed December 28, 2005 [#44]; Mid-Continent Casualty Company's Request to Rule on Mid-Continent Casualty Company's Summary Judgment First, filed December 29, 2005 [#46]; Mid-Continent's Response to the Daneshjou's Motion to Dismiss and Alternative Motion to Stay, and supporting Appendix, filed January 3, 2006 [#53]; Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of Band-Aid Trust's Memorandum in Response to Plaintiff's Motion for Summary Judgment, filed January 13, 2005 [#55]; Daneshjou Company, Inc., M.B. Daneshjou and Sally Daneshjou's response to Mid-Continent Casualty Company's Motion for Final Summary Judgment, filed January 13, 2006 [#56]; Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of Band-Aid Trust's Motion to Dismiss Counterclaim, filed January 17, 2006 [#58]; Supplement to Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of Band-Aid Trust's Memorandum in Response to Plaintiff's Motion for Summary Judgment, filed January 17, 2006 [#59]; and Mid-Continent Casualty Company's Reply to the Daneshjou Parties' Response to Mid-Continent Casualty Company's Motion for Summary Judgment, filed January 27, 2006 [#60]. Having considered the motions, responses and replies thereto, the case files as a whole and the applicable law, the Court enters the following opinion and orders.

I. Background

Plaintiff Mid-Continent Casualty Company ("MCC") filed this action against Defendants the Daneshjou Company, Inc. ("DCI"), M.B. Danesjou, Sally Daneshjou (collectively the "Daneshjou Defendants"), Sandra Bullock and John W. Bullock, Individually and as Trustee of Band-Aid Trust (collectively the "Bullock Defendants").

MCC issued a series of insurance polices covering DCI,

specifically: (1) a commercial general liability policy, number 04-GL-00041922, effective September 29, 2000 through September 29, 2001; (2) an excess policy, number XS116590, effective March 26, 2001 through March 26, 2002; (3) a commercial general liability policy, number 04-GL-000062812, effective September 29, 2001 through March 26, 2002; (4) a commercial general liability policy, number 04-GL-000094009, effective June 20, 2002 through June 20, 2003; and (5) a commercial general liability policy, number 04-GL-000118910, effective June 20, 2003 through June 20, 2004 (the "Policies"). The core issue involved in this lawsuit is the extent of coverage provided by the Policies. MCC seeks a declaration for the Court that it did not have a duty to defend or indemnify DCI or M.B. Daneshjou in connection with certain litigation.

Specifically, the question of insurance coverage arises from a lawsuit commenced in Travis County, Texas on June 21, 2001 (the "Underlying Litigation") by DCI. By way of the Underlying Litigation, DCI sought payments under a construction contract and change orders related to the construction of a residence for Sandra Bullock. The Bullock Defendants counterclaimed, asserting DCI and M.B. Daneshjou had improperly constructed the residence and had committed fraud. The underlying litigation eventually resulted in a jury verdict, with a final judgment exceeding $7.94 million. MCC subsequently filed this suit requesting a declaratory judgment establishing there was no duty to indemnify or provide coverage to any of the defendants under the Policies.

The parties have no filed motions and pleadings seeking a variety of relief. The Bullock Defendants have filed a motion to dismiss, asserting they are not proper parties to this action, and seeking substitution of Sally Daneshjou in their place. They have also filed a motion to dismiss the counterclaim they previously asserted against Plaintiff.

The Daneshjou Defendants have filed a motion to dismiss, arguing that Plaintiff has failed to join an indispensable party. Alternatively, they maintain this action should be stayed pursuant to several federal abstention doctrines.

Plaintiff MCC has filed a motion for summary judgment as to all of their claims against the Defendants. They have also requested the Court rule on their motion for summary judgment before considering the motions of the other parties.

The parties have filed responsive pleadings and the matters are now ripe for determination. Because a ruling on the motion might render the requests of the other parties moot, the undersigned will address the Daneshjou Defendants' request for abstention first.

II. Daneshjou Defendants' Motion to Stay/Abstain

The Daneshjou Defendants have asked this Court to abstain from hearing this case or, alternatively, stay this action in favor of a case currently pending in Texas state court. According to the Daneshjou Defendants, Truck Insurance Exchange ("Truck") filed suit in September 2005 in the Texas state court against MCC (the "State Action"). Truck asserts it provided a defense to DCI and M.B. Daneshjou in the Underlying Litigation under a commercial general liability policy. Truck further asserts, despite tendering those claims to MCC for coverage and indemnification, MCC refused to participate in defense of the Underlying Action. By the way of the State Action, Truck seeks a declaration that MCC had a duty to defend and breached the duty by failing to participate in the Underlying Litigation. Truck seeks both declaratory relief and unspecified money damages. (Daneshjou Def. Mot. To Dism. Ex. A). In November 2005 the Daneshjou Defendants filed pleadings in the State Action, seeking to intervene based

on their assertion MCC owed a duty to defend them in the Underlying Litigation. (*Id.* Exs. B & C).

The Daneshjou Defendants maintain, because the State Action concerns the same issues raised in this action, this Court's litigation of the matter would be unnecessarily duplicative. Accordingly, they seek a stay or dismissal of this action under several abstention doctrines.

Before turning to the merits of the application of each doctrine, the undersigned notes, as a general rule, federal courts have a "virtually unflagging obligation" to exercise the jurisdiction given them. *Bank One, N.A. v. Boyd*, 288 F.3d 181, 184 (5th Cir. 2002) (abstention is the exception, not the rule). However, a federal court may stay or dismiss a case in favor of a concurrent state court proceeding in "extraordinary and narrow" circumstances. *Murphy v. Uncle Ben's, Inc.*, 168 F.3d 734, 737 (5th Cir. 1999). The court must base the decision on considerations of "[w]ise judicial administration, giving regard to conservation of judicial resources and comprehensive disposition of litigation." *Colorado River Water Conservation Dist. v. United States*, 420 U.S. 800, 813, 96 S. Ct. 1236, 1236 (1976).

Defendants first argue this Court should abstain from hearing this action under the abstention doctrine recognized in *Burford v. Sun Oil Company*, 319 U.S. 315, 63 S. St. 1098 (1943). Under *Burford*, a federal court may abstain from interfering with the proceedings or orders of state administrative agencies in favor of available timely and adequate state court review: (1) when there are difficult questions of state law bearing on policy problems of substantial import whose importance transcends the result in the case at bar; or (2) where the exercise of federal review of the questions in a case and in similar cases would be disruptive of state efforts to establish a coherent policy with respect to a matter of

substantial public concern. *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 726-27, 116 S. Ct. 1712, 1726 (1996); *St. Paul Ins. Co. v. Trejo*, 39 F.3d 585, 588 (5th Cir. 1994).

Burford abstention is to be applied only sparingly. *See Holden v. Connex-Metalna Mgmt. Consulting GmbH*, 302 F.3d 358, 363 (5th Cir. 2002) (*Burford* abstention doctrine acts as narrow exception to rule that federal courts have strict duty to exercise jurisdiction conferred by Congress). Moreover, as MCC points out, *Burford* abstention is properly applied where there is a comprehensive state regulatory scheme and corresponding administrative proceeding or order. *See New Orleans Pub. Serv., Inc. v. Council of City of New Orleans*, 491 U.S. 350, 361, 109 S. Ct. 2506, 2514 (1989) (when *Burford* criteria are met federal court "must decline to interfere with the proceedings or orders of state administrative agencies"); *Webb v. B.C. Rogers Poultry, Inc.*, 174 F.3d 697, 700 (5th Cir. 1999) (*Burford* abstention doctrine allows federal court to abstain from exercising its jurisdiction in deference to complex state administrative procedures); *Williamson v. Guadalupe County Groundwater Conservation Dist.*, 343 F. Supp.2d 580, 595 (W.D. Tex. 2004) (*Burford* is concerned with protecting complex state administrative processes from undue federal influence). The Daneshjou Defendants assert this case falls within the ambit of *Burford* abstention because the states are responsible for insurance regulation. *See Barnhardt Marine Ins., Inc. v. New England Int'l. Sur., Inc.*, 961 F.2d 529, 530 (5th Cir. 1992) (applying *Buford* abstention in favor of case pending in state court filed by state Commissioner of Insurance for liquidation of insurer). This action dos not, however, involve an issue of regulation of the insurance industry. Rather, it simply involves question of insurance contract interpretation. Accordingly, the undersigned concludes *Burford* abstention is not appropriate here. The Daneshjou Defendants also argue this Court should abstain from exercising jurisdiction or stay this action under the doctrines

announced by the Supreme Court in *Colorado River* and *Brillhart v. Excess Ins. Co*, 316 U.S. 491, 62 S. Ct. 1173 (1942). *Brillhart* abstention is applicable to declaratory judgment actions. *Southwind Aviation, Inc. v. Bergen Aviation, Inc.*, 23 F.3d 948, 950 (5th Cir. 1994). In contrast, when coercive relief is requested, the trial court must apply the standards enunciated in *Colorado River*. *Id.* at 951. The Fifth Circuit has repeatedly held when parties seeks both injunctive and declaratory relief, the propriety of abstention must be assessed solely under the doctrine of *Colorado River*. *Black Sea Inv., Ltd. v. United Heritage Corp.*, 204 F.3d 647, 652 (5th Cir. 2000); *Southwind Aviation*, 23 F.3d at 951; *PPG Indus., Inc. v. Continental Oil Co.*, 478 F.2d 674, 679 (5th Cir. 1973). Although Plaintiff here ahs sought only declaratory relief, the Daneshjou Defendants have asserted several counterclaims, including claims for monetary damages resulting from breach of contract, the Texas Deceptive Trade Practices Act and violations of the Texas Insurance Code. Accordingly, abstention under *Brillhart* is not appropriate here.

Colorado River abstention is limited to cases involving "exceptional circumstances." *Colorado River*, 424 U.S. at 818, 96 S. Ct. at 1246. The Supreme Court has identified six factors relevant to determining whether exceptional circumstances exist permitting abstention: (1) assumption by either court of jurisdiction over a res; (2) the relative inconvenience of the forums; (3) the avoidance of piecemeal litigation; (4) the order in which jurisdiction was obtained by the concurrent forums; (5) whether and to what extent federal law provides the rules of decision on the merits; and (6) the adequacy of the state proceedings in protecting the rights of the party invoking federal jurisdiction. *Wilton v. Seven Falls Co.*, 515 U.S. 277, 285-86, 115 S. Ct. 2137, 2142 (1995). No single factor is determinative. *Snap-On Tools Corp. v. Mason*, 18 F.3d 1261, 1264 (5th Cir. 1994).

Here, most of the factors either are neutral or weigh against abstention. This case does not involve any res or property. *See Black Sea*, 204 F.3d at 650-51 (absence of this factor weighs against abstention); *Murphy v. Uncle Ben's, Inc.*, 168 F.3d 734, 738 (5th Cir. 1999) (same). Both courts are located in Austin, Texas, mere blocks from one another. Thus, the issue of convenience is irrelevant. *Murphy*, 168 F.3d at 738 (factor inapplicable where federal and state court suits both in south Texas). This case and thee State Action involve the same parties and the same issue, whether the Policies issued by MCC mandated coverage and defense of the Underlying Litigation. The lawsuits are, thus, duplicative, not piecemeal. *See Evanston Ins. Co. v. Jimco, Inc.*, 844 F.2d 1185, 1192 (5th Cir. 1988) (prevention of duplicative litigation not factor to be considered in abstention determination). Although the instant case involves only issues of state law and plaintiffs may enforce their rights in state court, those factors do not weigh in favor of abstention. *See Evanston*, 844 F.2d at 1193 (absence of federal law issue does not counsel in favor of abstention.) Finally, the order in which jurisdiction was obtained by the concurrent forums also weighs against abstention. The State Action was filed in September 2005, some six months after this case was filed. According to MCC, significant document production and other discovery has occurred in this action. In addition, the discovery deadline is fast approaching. In contrast, very little discovery has taken place in the State Action, and there is no discovery deadline set in the case. (MCC Resp. App. Ex. B-G). After carefully balancing the relevant factors, the Court determines there are no "exceptional circumstances" warranting the stay of this litigation in favor of the pending state court proceeding. Accordingly, the Daneshjou Defendants' motion for abstention or stay of this action is denied.

III. Daneshjou Defendants' Motion to Dismiss

The Daneshjou Defendants have also moved to dismiss

this action. They argue MCC has failed to join an indispensable party, named Truck. The Federal Rules of Civil Procedure permit a party to bring a motion to dismiss a complaint for failure to join a party under Rule 19. Fed. R. Civ. P. 12(b)(7). Proper joinder under Rule 19 is a two-step process. First, the district court must decide if the absent party is a necessary party to the action. *See Pulitzer-Polster v. Pulitzer*, 784 F.2d 1305, 1308 (5th Cir. 1986) (Rule 19 seeks to bring into lawsuit all persons who ought to be there by requiring joinder). A party is "necessary" if:

> (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest.

FED. R. CIV. P. 19(a). Second, if the absent party is a necessary party, but cannot be joined in the action because joinder would defeat the court's diversity jurisdiction, the court must determine "whether in equity and good conscience the action should proceed among the parties before it." Fed. R. Civ. P. 19(b); *HS Res., Inc. v. Wingate*, 327 F.3d 432, 439 (5th Cir. 2003). In making this determination, the court must consider four factors:

> First, to what extent a judgment rendered in the person's absence might be prejudicial to the person or those already parties; second,

> the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; third, whether a judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder.

FED. R. CIV. P. 19(b). Dismissal is required only if the absent party is trule "indispensable." *Wingate*, 327 F.3d at 439 n.11.

The core issue in this case is a question of contract interpretation. MCC seeks a declaration of the effect of the Policy issued to DCI. Truck is not a party to that policy. Accordingly, Truck has no right of recovery under the Policy against MCC. Truck's absence does not, therefore, prevent a determination of relief appropriate among those already parties. Nor does Truck's status as a co-insure of DCI, and consequent possibility of a right of reimbursement, make it an indispensable or even a necessary party to the litigation. *See Nottingham v. Gen'l. Am. Commc'ns Corp.*, 811 F.2d 873, 880 (5th Cir. 1987) (joinder of entities against whom parties have no claim for contribution not required). Moreover, Plaintiff's decision to seek relief from this Court, in the absence of Truck a party, indications MCC is not concerned about the risk of incurring double, multiple, or otherwise inconsistent obligations. Accordingly, the Court concludes Truck is not a "necessary" party as defined by Rule 19(a). Based upon this finding, the Court need not proceed to step two of the process to determine whether the absent parties are "indispensable" to this action. The Daneshjou Defendants' motion to dismiss on this basis is, thus, denied.

IV. Bullock Defendants' Motion to Dismiss and Motion to Substitute Parties

The Bullock Defendants have filed a motion to dismiss, asserting they are not proper parties to this action, and seeking substitution of Sally Daneshjou in their place. In addition, as part of their amended answer, they have also filed a motion to dismiss the counterclaim they previously asserted against Plaintiff.

According to the Bullock Defendants, they have executed an agreement transferring all of their interests in the final judgment of the Underlying Litigation, and any claims they have in this litigation, by way of interests of the Daneshjou Defendants, to Sally Daneshjou. They thus seek dismissal of the claims against them, by way of substitution of the now-real party in interest, Sally Daneshjou. When an interest of a party to a civil action has been transferred "the action may be continued by or against the original party, unless the court upon motion directs the person to whom the interest is transferred to be substituted in the action or joined by the original party." FED. R. CIV. P. 25(c). During the November 18 hearing in this case, the Court considered both the Bullock Defendants' motion to substitute and the motion to intervene of Sally Daneshjou. The Court permitted Sally Daneshjou to intervene, but delayed ruling on the motion of the Bullock Defendants, pending their production of documents to counsel for MCC. Based on submissions by the parties concerning the production, the Court is now satisfied that the Bullock Defendants have fully complied with the Court's order. Accordingly, they are entitled to dismissal of the claims against them, in favor of Sally Daneshjou, and to dismissal of their counterclaim.

V. Plaintiff's Motion for Summary Judgment

MCC has filed a motion for summary judgment regarding Defendants' entitlement to coverage under the Policies. MCC contends the defects at issue in the Underlying Litigation manifested themselves prior to the coverage afforded by the Policies, and are thus not covered. MCC also maintains

the type of damages awarded in the Underlying Litigation are not covered under the Policies. The Daneshjou Defendants argue fact issues prevent the grant of summary judgment.1

A. Standard of Review

Summary judgment is appropriate under Rule 56(c) of the Federal Rules of Civil Procedure only "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). A dispute is genuine only if the evidence is such that a reasonable jury could return a verdict for the nonmoving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 254, 106 S. Ct. 2505, 2513 (1986).

The party moving for summary judgment bears the initial burden of "informing the district court of the basis for its motion, and identifying those portions of [the record] which it believes demonstrates the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett,* 477 U.S. 317, 323, 106 S. Ct. 2548, 2553 (1986). The burden then shifts to the nonmoving party to establish the existence of a genuine issue for trial. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 57, 585-87, 106 S. Ct. 1348, 1355-56 (1986); *Wise v. E.I. Dupont de Nemours & Co.,* 58 F.3d 193, 195 (5th Cir. 1995). The non-movant must respond to the motion by setting forth particular facts indicating there is a genuine issue for trial. *Mississippi River Basin Alliance v. Westphal*, 230 F.3d 170, 174 (5th Cir. 2000). "After the non-movant has been

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1 The Bullock Defendants have not responded to the merits of MCC's motion, but simply reassert their request for dismissal, in favor of Sally Daneshjou. In light of the Court's ruling permitting substitution and dismissing all claims agains the Bullock Defendants, the Court need not consider the issue of summary judgment as to them.

given the opportunity to raise a genuine factual issue, if no reasonable juror could find for the non-movant, summary judgment will be granted." *Id.*

The parties may satisfy their respective burdens by tendering depositions, affidavits or other competent evidence. *Topalian v. Ehrman*, 954 F.2d 1125, 1131 (5th Cir. 1992). Unsubstantiated or conclusory assertions, improbable inferences, and unsupported speculation are not competent summary judgment evidence and thus are insufficient to defeat a motion for summary judgment. *Eason v. Thaler*, 73 F.3d 1322, 1325 (5th Cir. 1996); *Forsyth v. Barr*, 19 F.3d 1527, 1533 (5th Cir. 1994).

B. Applicable Law

A federal court sitting in diversity must apply the law of the forum state, in this case, Texas. *Harken Exploration Co. v. Sphere Drake Ins. P.L.C.*, 261 F.3d 466, 470 (5th Cir. 2001). MCC has requested this Court determine whether it had a duty to indemnify any of the Defendants or damages awarded in the Underlying Litigation. An insurer's duty to indemnify is distinct from the duty to defend, and is a narrower duty. *St. Paul Fire & Marine Ins. Co. v. Green Tree Fin. Corp.-Tex.*, 249 F.3d 389, 391 (5th Cir. 2001); *Hardy v. Hartford Ins. Co.*, 236 F.3d 287, 290 (5th Cir. 2001). Thus, if an insurer has no duty to defend, it has no duty to indemnify. *American States Ins. Co. v. Bailey*, 133 F.3d 363, 368 (5th Cir. 1998).

Texas courts apply the "eight-corners" or "compliant allegation" rule in deciding whether an insurer owes a duty to defend. *Potomac Ins. Co. v. Jayhawk Med. Acceptance Corp.*, 198 F.3d 548, 551 (5th Cir. 2000); *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 187 (Tex. 2002). Under this rule, courts must determine whether an insurer owes a duty to defend "solely from the allegations in the most recent [underlying] petition and the language of the insurance policy." *Harken*, 261 F.3d at

471, *King*, 85 S.W.3d at 187. "The focus of this inquiry is on the facts alleged, not on the actual legal theories." *St. Paul*, 249 F.3d at 392. The insured bears the burden of showing that the claim against it is potentially within the insurance policy's scope of coverage. *Harken*, 261 F.3d at 471.

C. Analysis

MCC first contends that it is entitled to summary judgment because all of the actual damages awarded in the Underlying Litigation manifested themselves prior to the earliest date of coverage provided by the Policies.2 As the Fifth Circuit has recognized, the Texas Supreme Court has never explicitly adopted a specific theory governing the triggering event for the insurer's duty to defend. *Guaranty Nat'l. Ins. Co. v. Azrock Indus., Inc.*, 211 F.3d 239, 246 (5th Cir. 2000) (court must make "best *Erie* guess as to what Texas would choose"). At issue in *Azrock* was the appropriate theory to use in the latent disease context. In discussing the different theories, the Fifth Circuit specifically recognized the proper theory to use in cases involving property damage was the manifestation theory. *Id.* At 247-48. *See also American Home Assur. Co. v. Unitramp Ltd.*, 146 F.3d 311, 313 (5th Cir. 1998) (under Texas law, time of occurrence is not when wrongful act was committed, but when complaining party sustains damage that is readily apparent). *But see Pilgrim Enters., Inc. v. Maryland Cas. Co.*, 24 S.W.3d 488, 494-98 (Tex. App.—Houston [1st Dist.] 2000, no. pet.) (acknowledging *Azrock* holding, Texas Supreme Court's failure to rule, Dallas and Austin appellate courts' adoption of "relaxed" manifestation

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2 The Court notes MCC also reserves the right to demonstrate the claims asserted in the Underlying Litigation did not constitute "property damage" caused by an "occurrence" so as to fall within the coverage afforded under the Policies. As MCC points out, these issues are currently pending before the Texas Supreme Court. Because the Court finds MCC's other arguments well-taken, there is no need to delay ruling in this case in deference to the Texas Supreme Court's pending decisions.

theory, but concluding exposure theory appropriate in cases of continuous or repeated exposure, even where property damages involved). Accordingly, this Court will apply the manifestation theory.

Under the manifestation theory, there is an "occurrence" triggering coverage, "not when the causative negligence occurs" but on the date the "damage[s] become capable of being easily perceived or recognized." *Azrock*, 211 F.2d at 246-47. *See also Cullen/Frost Bank of Dallas V. Commonwealth Lloyd's Ins. Co.*, 852 S.W.2d 252, 258 (Tex. App.—Dallas 1993, no writ.) ("the occurrence takes place when the property damage manifests itself"). As noted above, to determine when the damages became capable of perception, the Court will turn to the allegations in the final pleadings in the Underlying Litigation. *See Texas Prop. & Cas. Ins. Guar. Ass'n v. Southwest Aggregates, Inc.*, 982 S.W.2d 600, 604 (Tex. App. —Austin 1998, no pet.) ("duty to defend is not affected by facts ascertained before suit, developed in the process of litigation, or by the ultimate outcome of the suit").

By way of their Second Amended Counterclaim, the Bullock Defendants made the following "Allegation[s] of Basic Facts:"

> By the terms of the Construction Contract, construction was scheduled for completion within 16 months of the execution date, i.e., by June 1999. The foundation for the Main House on the Property was poured on or about May 4, 1998. When work on the Property was suspended 24 months later in May 2000, construction remained unfinished.
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> ***

Construction was suspended in May 2000 to permit Bullocks' representatives to inspect the property and DCI's records. The Bullocks devoted considerable time and resources in an effort to account for payments made to DCI and Daneshjou and to determine the extent to which work performed by DCI and Daneshjou and their employees and subcontractors was satisfactorily competed.

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DCI and Daneshjou received and have not accounted for unearned "advances" paid by the TRUST totaling $224,900.00

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DCI and Daneshjou failed to account for the actual costs incurred for management/overhead, in addition to contractor fees, fees for "architectural plans" and fees payable for "monitoring "tech assistance" and other items, in breach of their contractual obligation

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DCI and Daneshjou failed to account for actual labor costs contrary to the terms of the Construction Contract and inflated labor costs through the use of an affiliated company

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[O]n May 21, 2000, DCI prepared a document entitled "Payments received and Draws Balance to Date ledger" which inserted at arbitrarily dated and false entries, for the period from February 1998 through April 2000, charges to the TRUST's account for architectural fees in excess of the charge established by the pre-construction contract.

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During the period from February 1998 through April 2000, DCI assigned charges to "change orders"...which total $4,844,439.15, increasing the amount paid to DCI to more than four times the original cost estimate of March 2000. Included in these "Change Orders" were (1) costs of repairs, tear-out and replacement of DCI's and Daneshjou's defective work not caused by the fault of the owner, (2) excessive charges for costs inflated by Daneshjou's shell company DDI, (3) charges for performing unnecessary work, and (4) charges for work that was not done.

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The services provided by DCI to the Bullocks in the construction of the improvements on the Property during the period from February 1998 through April 2000 were grossly substandard.

Engineering reports establish that improvements on the Property are unfit and

unsafe for occupancy, and the Principal Residence remains unoccupied as of this date. Engineering reports establish that every structure located on the Property will require substantial repair and reconstruction before the residence can be safely occupied, with the exception of the Boat House which must be completely razed and rebuilt. In addition, the terrain surrounding the main residence must be substantially modified to correct drainage problems resulting from the incompetent location and design of the foundation slab, and the unnecessary placement of a retaining wall on the north side of the property with accompanying alteration of the natural drainage. Similarly, the septic systems servicing the residences and boathouse must be removed and relocated. In the course of construction of the Main House, Guest House, Boat House, septic fields, and excavation of the grounds, a substantial portion of the landscaping and irrigation systems must be removed, and all Main House security systems, lighting control systems, and audio video systems must be removed, stored and reinstalled.

During the period between February 1998 and April 2000, DCI and Daneshjou charged the owner for and demanded and received payment for repairs to correct substandard work, including, but not limited to, repairs to the Main House roof, repairs from leaks and water intrusion, and excavation of terrain, relocation of main power lines and erection of a retaining wall

> to remedy flooding resulting from improper location of the Main House slab. None of these repairs were caused by the acts or omissions of the Bullocks.

(Daneshjou Def. Summ. Jt. Resp. App. Att. C at 8-15, paragraph numbers omitted.) The allegations made by the Bullock Defendants clearly reflect at least some awareness of issues with the practices of DCI and M.B. Daneshjou as of May 2000, the date on which construction was suspended. The allegations also set forth the various categories of damages asserted to have been incurred by the Bullock Defendants.

In addition, MCC has submitted evidence which establishes the Bullock Defendants contacted Ron Henson ("Henson"), a CPA, in late 1999 to review DCI's billing. (MCC Summ. Jt. App. Ex. A at 5). By fax dated January 27, 2000, Henson had notified John Bullock of possible labor overcharges. Henson subsequently submitted a report on May 31, 2000 in which he detailed concerns related to: (1) overcharges by DCI involving labor charges to DDI (identified in the Bullock Defendants' pleadings as a "shell corporation"); (2) advances paid DCI not subsequently properly credited to the work done for the Bullock Defendants; (3) overcharges by DCI for management/overhead; and (4) charges by DCI for other portions of the construction not sufficiently documents or supported by invoices. (*Id.* At 5-6 & Ex. H). These categories match the improper accounting and billing allegatins raised by the Bullock Defendants in the Underlying Litigation. (*Id.* Ex. C and 4-5).

The Bullock Defendants also hired a professional engineer, June Melton ("Melton"), in May 2000. (*Id.* Ex. A at 7). Melton was provided a "List of Deficiencies" previously compiled by Sandra Bullock's assistant, identifying more than 140 defects. (*Id.* Ex. A at 8, Ex. B at 3). Melton conducted an investigation of the design and construction deficiencies from

May 11, 2000 through September 20, 2000. Melton prepared a draft report of his findings which he transmitted to counsel for the Bullock Defendants on September 6, 2000. (MCC Summ. Jt. Reply Ex. K). Melton submitted his final report on February 26, 2001. Each of these reports listed the 278 defects which were the basis for the construction defect claims at issue in the Underlying Litigation. (MCC Summ. Jt. App. Ex. A at 8, Ex. B at 3-4). Notably, all but one of the consultants hired by Melton to perform inspections had submitted a report summarizing those findings by September 7, 2000. The final consultant report was submitted on September 21. (*Id.* Ex. A at 9).

MCC maintains this evidence shows each of the 278 construction defects was "documented, described, photographed and/or capable of being perceived or recognized during inspections from May 2000 through September 20, 2000." (MCC Summ. Jt. Mot. at 5). They further assert the evidence establishes the over billing and unsubstantiated billings had been identified in a report dated May 31, 2000. Accordingly, because the damages had manifested prior to the September 29, 2000 effective date of the Policies, MCC concludes there is no duty to defend or indemnify under the Policies.

The Daneshjou Defendants disagree, arguing the evidence has failed to establish each of the defects had actually "manifested" themselves. They point out the Bullock Defendants continued to employ experts who made additional inspections, and performed additional testing, the results of which were incorporated into evidence presented at trial in the Underlying Litigation. The Daneshjou Defendants note extensive destructive testing was not performed until October 2003, revealing for the first time, the extent of the problems with wall framing and water intrusion. (Daneshjou Def. Summ. Jt. Resp. App. Att. E at 4). They further contend

Henson's accounting report was not sufficient because it referenced "possible irregularities" in the billing process, and did not specifically identify overcharges for rework of substandard work.

Essentially, the Daneshjou Defendants contend the defects had not "manifested" themselves because the precise details and extent of each defect had not yet been discovered as of September 29, 2000, the date the Policies first went into effect. The Court disagrees. Under the manifestation theory, the words "manifested" or "identifiable" mean "capable of easy perception." *Unitramp*, 146 F.3d at 314. Significantly, however, the Fifth Circuit has cautioned "it is important to understand that 'apparent' does not mean 'discovered'; just because something is unknown to an individual does not render it, in an objective sense, unapparent." *Unitramp*, 146 F.3d at 314. Thus, the lack of actual discovery of the details of the defects is clearly not dispositive.

Further, the Court finds the argument of the Daneshjou Defendants relies on a misinterpretation of the fundamental character of the manifestation theory. The manifestation theory incorporates the "loss in progress" rule that an insurer cannot insure against a loss that is known or apparent to the insured. Thus, theinsurer on the risk at the time of discovered damage is liable for the entire loss, even if the property damage progresses after the policy expires. *See Chemstar, Inc. v. Liberty Mut. Ins. Co.*, 797 F. Supp. 1541, 1551 (C.D. Cal. 1992) ("coverage is triggered when property damage first manifests, and the insurer on the risk at the time of first manifestation is liable for the entire loss, even if the property damage progresses after the policy expires."). The loss-in-progress rule and the manifestation trigger combine to protect an insured's access to insurance. Even if damage manifests in a building, subsequent insurers would be willing to issue policies because they could rely on the loss-in-progress rule to preclude coverage for

progressive property damage. Moreover, this interpretation of the manifestation theory is in line with Texas law. *See Pilgrim*, 24 S.W.3d at 496 (concluding *Cullen/Frost* represents adoption of "relaxed" manifestation approach, recognizing coverage trigged "in first policy period during which discovery of injury is possible"). Thus, because the matters at issue in the Underlying Litigation manifested themselves prior to the effective date of any of the Policies, those matters fell outside of the coverage provided by the Policies. Accordingly, the Court concludes MCC had no duty to defend, and consequently to indemnify, under the Policies. *See Am. States*, 133 F.3d at 368 (if insurer has no duty to defend, it has no duty to indemnify).

MCC presents several additional arguments in support of the motion for summary judgment. Specifically, MCC argues the award of punitive damages in the Underlying Litigation is not covered under the Policies because: (1) such damages are not "bodily injury" or "property damage" arising from an "occurrence" within the meaning of the language of the Policies; (2) the Daneshjou Defendants did not become "legally obligated to pay" these additional damages because of "bodily injury" or "property damage;" (3) such damages are precluded under an exclusion to the Policies for damages expected or intended from the standpoint of the insured; (4) they were awarded to punish the Daneshjou Defendants for causing actual damages manifested outside the policy period; and (5) insurance coverage for such damages is contrary to public policy. MCC further denies liability for the damages awarded in the Underlying Litigation because each category of damages comprised economic damages, not property damages.

The Court notes, although MCC has not so identified these arguments, the additional grounds for relief are presumably proffered solely as alternatives. Because the undersigned has found the Policies did not extend coverage to

the Daneshjou Defendants for the matters at issue in the Underlying Litigation, thus placing no duty to defend under the Policies on MCC, a ruling on MCC's additional arguments is unnecessary. Accordingly, Mid-Continent Casualty Company is entitled to summary judgment on all claims against it. Consequently, Mid-Continent Casualty Company's Request to Rule on Mid-Continent's Summary Judgment First is moot.

In accordance with the foregoing:

IT IS ORDERED that Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of the Band-Aid Trust's Motion to Dismiss and Substitute Parties [#13] is GRANTED;

IT IS FURTHER ORDERED that the Defendants, Sandra Bullock and John W. Bullock, Individually and as Trustee of the Band-Aid Trust's Motion to Dismiss Counterclaim [#58] is GRANTED;

IT IS FURTHER ORDERED that Defendants M.B. Daneshjou, Daneshjou Company, Inc., and Sally Daneshjou Motion to Dismiss and Alternative Motion to Stay [#39] is DENIED;

IT IS FURTHER ORDERED that Mid-Continent Casualty Company's Motion for Final Summary Judgment [#40] is GRANTED;

IT IS FURTHER ORDERED that Mid-Continent Casualty Company's request to Rule on Mid-Continent's Summary Judgment First [#46] is DENIED as moot.

SIGNED this the 14th day of February 2006.

//original signed by Sam Sparks//
SAM SPARKS
UNITED STATES DISTRICT JUDGE